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UNCLAS SECTION 01 OF 02 YEREVAN 002406

SIPDIS

SENSITIVE

STATE FOR EUR/CACEN FOR SIDEREAS, EUR/ACE FOR LONGI, EB/ESC,
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SUBJECT: POWER STRUGGLE: ARMENIA SELLS GEORGIA CHEAP
ELECTRICITY

Ref: A. TBILISI 2773 B. YEREVAN 1453 C. YEREVAN 2216 D.

YEREVAN 2367

1. This cable is sensitive but unclassified. Please
protect accordingly.

SUMMARY

2. (SBU) Sources in Armenia's energy sector claim that,
following the October 10 sabotage of transmission lines from
Russia (Ref A), the Georgian government forced Armenia to
sell electricity to Georgia below cost by threatening to
raise transport tariffs on goods bound for Armenia. Sources
in the Government of Armenia told us the sale was "not
unusual" and have denied allegations that Georgia threatened
to raise tariffs if it did not receive cheap electricity.
Whatever the story behind the deal, the concessionary sale
to Georgia costs the Armenian energy sector USD 300,000 per
month, and illustrates a current feeling of vulnerability to
transport through Georgia exacerbated by the recent closing
of the Russia Georgia border (Refs C, D). End Summary.

ARMENIA EXPORTS POWER TO GEORGIA ON THE CHEAP

3. (SBU) Armenia has started exporting electricity (60MW) to
Georgia below the cost of production, in effect subsidizing
Georgia's electricity market. Following the October 10
sabotage of transmission lines from Russia, ArmRosGazProm
and United Distribution Company of Georgia entered into an
agreement that Armenia will export electricity to Georgia at
last year's rate of 2.5 U.S. cents kW/h through the end of
March 2005, with a price adjustment mechanism if the gas
price rises before that time. According to Armenian law,
only the highest marginal cost electricity may be used for
export. Based on current operations, the highest cost
generation plant is Hrazdan Thermal Power Plant, which is
operating at about 50 percent capacity. Its tariff for
Armenian consumers is 15.22 ADM (about 3.05 U.S. cents) per
kW/h. According to technical advisors to the Public
Services Regulatory Commission (PRSC), which set the price
in this case, the difference between the actual cost of
generation and transmission and the 2.5 U.S. cents per kW/h
tariff for 60 MW could be as high as USD 300,000 per month.
Armenian consumers will bear the cost in the form of higher
electricity tariffs.

POWER AND INFLUENCE

4. (SBU) PA Consulting, which serves as the technical
advisor to the Ministry of Energy and the PRSC in Armenia
and is also the buyer of the electricity in Georgia, told us
that Georgia's Prime Minister called on the Government of
Armenia to use Armenia's excess generation capacity to meet
Georgia's unmet demand. Sources disagree about whether
Georgia threatened to raise the transit tariffs of Armenia-
bound goods through Georgian territory by 20 percent if
Armenia refused to deliver the electricity at last year's
rates. (Note: More than 90 percent of Armenia's non-
diamond trade transits Georgia. End Note.) In any case,
there was doubtless uncertainty about what price to charge
Georgia. Before the dissolution of ArmEnergo October 1, the
GOAM itself would have made the export through the state-
owned single buyer of electricity (Ref B). With ArmEnergo
out of the picture, Armenia's PRSC lacks market rules on
which to rely when setting price rules for foreign
governments or, for that matter, the private distributor.
Although the private distributor, Electricity Networks of
Armenia (ElNetArm), inherited ArmEnergo's export contracts,
the government effected the export through the state-
controlled ArmRosGazProm (55 percent Russian and 45 percent
Armenian owned).

COMMENT: CAUCASIAN HOSTAGE?

15. (SBU) While stories conflict about whether there were any threats from Georgia, no one disputes that Armenia is exporting electricity to Georgia at a rate less than marginal cost. If Georgia is seeking to profit from the perception of vulnerability and isolation in Armenia, its timing could not be better. The recent temporary, month-long closure of the Verkhniy-Lars border crossing between Russia and Georgia stranded hundreds of trucks bound for Armenia and diverted trade through the Georgian ports of Poti and Batumi at extra cost. Although Russia opened the border October 22 (Ref D), a recent visit by the Russian Minister of Transport did little but highlight the implausibility of alternative routes for Russian goods, including via the Caspian Sea and through Iran. As the transport of goods through Georgia faces more expense and obstacles, the GOAM is not likely to forget that more than half of the electricity that Armenia generates depends on gas that flows through from Russia through Georgia. While Armenia's Ministry of Trade has long pushed to reduce Georgia's transit tariffs on goods bound for Armenia, recent events remind the GOAM that Armenia's bargaining position is weak.

EVANS